

Part III - Administrative, Procedural, and Miscellaneous

Study on Donor Advised Funds and Supporting Organizations

Notice 2007-21

PURPOSE

This notice invites public comments in connection with a study being conducted by the Department of the Treasury (the Treasury) and the Internal Revenue Service (the Service) on the organization and operation of donor advised funds (as defined in § 4966(d)(2) of the Internal Revenue Code (Code)) and of supporting organizations described in § 509(a)(3). This study is required by § 1226 of the Pension Protection Act of 2006, Pub. L. No. 109-280, 120 Stat. 780 (2006) (the PPA).

BACKGROUND

Charitable organizations described in § 501(c)(3) are classified under § 509 as either public charities or private foundations, depending on their exempt purposes, the sources of their financial support, or their manner of operation. Private foundations, which typically derive their support from, and are often controlled by, a small number of donors, are subject to a number of anti-abuse rules and excise taxes not applicable to public charities. In addition, contributions to private foundations are subject to lower charitable deduction limits than are contributions to public charities.

Supporting Organizations

Under § 509(a)(3), a supporting organization is a § 501(c)(3) charitable organization that is classified as a public charity, not as a private foundation, as a result of the supporting organization's close relationship to one or more organizations described in §§ 509(a)(1) or 509(a)(2) (referred to in regulations under section 509(a)(3) as "publicly supported organizations"). To qualify as a supporting organization under § 509(a)(3), an organization must satisfy three requirements:

(A) the organization must be organized and at all times thereafter operated exclusively for the benefit of, to perform the functions of, or to carry out the purposes of one or more specified publicly supported organizations;

(B) the organization must be operated, supervised, or controlled by or in connection with one or more publicly supported organizations; and

(C) the organization must not be controlled directly or indirectly by one or more disqualified persons (as defined in § 4946) other than foundation managers and other than one or more publicly supported organizations.

Section 1.509(a)-4 of the Income Tax Regulations provides that the second requirement is met if the supporting organization has one of three relationships with one or more publicly supported organizations. A "Type I" supporting organization is "operated, supervised, or controlled by" a publicly supported organization. This relationship is comparable to that of a parent and subsidiary in that one or more publicly supported organizations can direct the policies, programs or activities of the supporting organization. A "Type II"

supporting organization is “supervised or controlled in connection with” one or more publicly supported organizations. In this relationship, the supporting organization and the publicly supported organization(s) are under common supervision or control. A “Type III” supporting organization is “operated in connection with” a publicly supported organization. An organization will qualify as a Type III supporting organization only if it meets certain tests designed to ensure that the organization will be responsive to, and significantly involved in the operations of, the publicly supported organization(s). Under the PPA, this previously informal nomenclature used to describe the relationship between a supporting organization and its publicly supported organizations is incorporated into new §§ 4942(g)(4), 4943(f)(5) and (6), and 4966(d)(4).

Donor Advised Funds

Prior to the PPA, the term donor advised fund was not defined in the Code. However, the term generally was understood to refer to separate funds or accounts established and maintained by public charities to receive contributions from a single donor or a group of donors. The charities had ultimate authority over how the assets in each account were invested and distributed, but the donors, or individuals selected by the donors, were permitted to provide nonbinding recommendations regarding account distributions and/or investments. Donor advised funds often were compared to component funds of certain community trusts. See §§ 1.170A-9(e)(10) and (11).

The PPA adds new § 4966(d)(2), which defines a donor advised fund as a fund or account that is owned and controlled by a sponsoring organization,

separately identified by reference to contributions of a donor or donors, and with respect to which the donor or a person appointed or designated by the donor (donor advisor) has or reasonably expects to have advisory privileges with respect to the distribution or investment of the assets in the fund. The term donor advised fund does not include a fund or account (1) that makes distributions only to a single identified organization or governmental entity, or (2) with respect to which a donor advises a sponsoring organization regarding grants for travel, study or similar purposes, provided that certain requirements are met.

A sponsoring organization is defined under new § 4966(d)(1) as a § 170(c) organization that is not a governmental organization (referenced in §§ 170(c)(1) and (2)(A)) or a private foundation and maintains one or more donor advised funds.

Supporting Organizations and Donor Advised Funds as Alternatives to Private Foundations

Traditionally, supporting organizations and donor advised funds have offered donors certain advantages relative to private foundations, such as the possibility of a higher charitable contribution deduction and the avoidance of certain limitations that apply to private foundations, including the § 4941 self-dealing rules, the § 4942 annual payout requirements, and the § 4943 business holdings limits. Although certain advantages remain, new rules enacted as part of the PPA add certain requirements for deductibility of charitable contributions to donor advised funds and impose new restrictions on the operations of donor advised funds and supporting organizations.

New Rules Affecting Supporting Organizations and Donor Advised Funds under the PPA

The PPA contains several provisions intended to improve the accountability of donor advised funds and supporting organizations (see §§ 1226, 1231-1235 and 1241-1245 of the PPA). Those PPA provisions add §§ 4966 and 4967 to the Code, and amend §§ 170, 508, 509, 2055, 2522, 4942, 4943, 4945, 4958, and 6033 of the Code. For a description of some of the new rules, see Notice 2006-109, 2006-51 I.R.B. 1121 (December 18, 2006).

The new rules affecting supporting organizations include: excise taxes on certain payments to a substantial contributor or a related person and on the entire amount of any loan to a disqualified person (§ 4958(c)(3)); the extension of § 4958 to transactions between a supported organization and a person who is a disqualified person of a supporting organization (§ 4958(f)); a grant of regulatory authority to adopt a new payout requirement for certain Type III supporting organizations (PPA § 1241(d)); limits on the permitted business holdings of certain supporting organizations (§ 4943(f)); organizational and operational requirements (§ 509(f)); and reporting requirements (§§ 6033(a)(3)(B) and 6033(l)). In addition, new rules apply to certain private foundations that make grants to certain supporting organizations (§§ 4942(g)(4) and 4945(d)(4)(A)).

The new rules affecting donor advised funds include: definitions of the terms “sponsoring organization” and “donor advised fund” (§ 4966(d)); excise taxes on certain taxable distributions from a donor advised fund (§ 4966(c)); excises taxes on donors, advisors, or related persons who receive certain

benefits as a result of a distribution from a donor advised fund (or who advise as to such a distribution) (§ 4967); excise taxes on payments from a donor advised fund to any donor, advisor, or a related person (§§ 4958(c)(2) and 4958(f)(1)(E)); the extension of § 4958 to transactions between the sponsoring organization and certain investment advisors or related persons (§§ 4958(f)(1)(F) and 4958(f)(8)); limits on permitted business holdings (§ 4943(e)); substantiation requirements (§§ 170(f)(18), 2055(e)(5) and 2522(c)(5)); and reporting and disclosure requirements for sponsoring organizations (§§ 508(f) and 6033(k)).

Deductible Charitable Contributions

Generally, an income tax deduction is allowed under § 170 for a charitable contribution made in the year the deduction is claimed, subject to certain limitations and substantiation requirements. See, e.g., U.S. v. American Bar Endowment, 477 U.S. 105 (1986); §§ 1.170A-1(a) and 1.170A-13. Charitable contributions also may be deductible for gift or estate tax purposes. §§ 2522 and 2055. Under the PPA, a taxpayer may deduct a contribution to a donor advised fund only if the sponsoring organization receiving the contribution is one of certain specified types, and the taxpayer making the contribution obtains an acknowledgement from the sponsoring organization that the organization has exclusive legal control over the property contributed. §§ 170(f)(18), 2522(c)(5), and 2055(e)(5).

ISSUES IDENTIFIED FOR FURTHER STUDY UNDER THE PPA

In discussing § 1226 of the PPA, the Technical Explanation prepared by the Joint Committee on Taxation states, in part, “Elsewhere in the bill, provision

is made for new rules with respect to donor advised funds and supporting organizations. Many issues arise under current law with respect to such organizations, some of which are addressed in the bill and some of which would benefit from additional study.”¹

Section 1226 of the PPA provides that the Secretary shall undertake a study on the organization and operation of donor advised funds and supporting organizations, and that the study shall specifically consider:

(1) whether the deductions allowed for income, gift, or estate taxes for charitable contributions to sponsoring organizations of donor advised funds or to supporting organizations are appropriate in consideration of (i) the use of contributed assets (including the type, extent, and timing of such use) or (ii) the use of the assets of such organizations for the benefit of the person making the charitable contribution (or a person related to such person),

(2) whether donor advised funds should be required to distribute for charitable purposes a specified amount (whether based on the income or assets of the fund) in order to ensure that the sponsoring organization with respect to the fund is operating consistent with the purposes or functions constituting the basis for its exemption under § 501 or its status as an organization described in § 509(a),

(3) whether the retention by donors to donor advised funds or supporting organizations of rights or privileges with respect to amounts transferred to such organizations (including advisory rights or privileges with respect to the making of

¹ Joint Committee on Taxation, *Technical Explanation of H.R. 4, The “Pension Protection Act of 2006,” as Passed by the House on July 28, 2006 and as Considered by the Senate on August 3, 2006*, (JCX-38-06), August 3, 2006, at 333.

grants or the investment of assets) is consistent with the treatment of such transfers as completed gifts that qualify for a deduction for income, gift, or estate taxes, and

(4) whether any of the issues described above also are issues with respect to other forms of charities or charitable donations.

REQUEST FOR PUBLIC COMMENTS

To assist in performing the required study, the Treasury and the Service request comments on the specific issues identified above and other issues relevant to the study. In particular, the Treasury and the Service request comments with respect to the following:

1. What are the advantages and disadvantages of donor advised funds and supporting organizations to the charitable sector, donors, sponsoring organizations, and supported organizations, compared to private foundations and other charitable giving arrangements?

2. How should the amount and availability of a charitable contribution deduction for a transfer of assets to a donor advised fund or a supporting organization, and the tax-exempt status or foundation classification of the donee, be determined if:

a. the transferred assets are paid to, or used for the benefit of, the donor or persons related to the donor (including, for example, salaries and other compensation arrangements, loans, or any other personal benefits or rights)?

b. the donor has investment control over the transferred assets?

c. there is an expectation that the donor's "advice" will be followed, or will be the sole or primary consideration, in determining distributions from, or investment of the assets in, the supporting organization or the donor advised fund?

d. the donor or the donee has option rights (e.g., puts, calls, or rights of first refusal) with respect to the transferred assets?

e. the transferred assets are appreciated real, personal, or intangible property that is not readily convertible to cash?

3. What are the effects or the expected effects of the PPA provisions (including the § 4958 excess benefit transaction tax amendments applicable to donor advised funds and supporting organizations) on the practices and behavior of donors, donor advised funds, sponsoring organizations, supporting organizations and supported organizations?

4. What would be appropriate payout requirements, and why, for:

a. donor advised funds?

b. funds that are excepted from donor advised fund treatment by statute or by the authority of the Secretary, but for which the donor retains meaningful rights with respect to the investment or use of the transferred amounts?

c. supporting organizations?

d. any other types of charities?

5. What are the advantages and disadvantages of perpetual existence of donor advised funds or supporting organizations?

6. What other types of charitable giving arrangements give rise to any of the above issues?

Section 1226 of the PPA provides that, not later than August 16, 2007, the Secretary shall submit to the Congress a report on the study. Comments should refer to Notice 2007-21 and be submitted by April 9, 2007, to:

Internal Revenue Service
P.O. Box 7604
Ben Franklin Station
Washington, D.C. 20044
Attn: CC:PA:LPD:PR
Room 5203

Alternatively, comments may be submitted electronically via e-mail to Notice.Comments@irsounsel.treas.gov. The comments you submit will be available for public inspection and copying.

DRAFTING INFORMATION

The principal authors of this notice are Robert Fontenrose of the Exempt Organizations, Tax Exempt and Government Entities Division, and Susan J. Kassell of the Office of Associate Chief Counsel (Income Tax & Accounting). For further information regarding exempt organization issues contact Mr. Fontenrose at (202) 283-9484 (not a toll-free call). For further information regarding charitable contribution issues, contact Ms. Kassell at (202) 622-5020 (not a toll-free call).